

Service Date: August 17, 2001

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

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| IN THE MATTER of the Application of      | ) | UTILITY DIVISION      |
| MONTANA POWER COMPANY for Approval       | ) |                       |
| of a Power Purchase Agreement with Rocky | ) | DOCKET NO. D2001.7.93 |
| Mountain Power, Inc.                     | ) | ORDER NO. 6361a       |

ORDER

Introduction and Background

1. On July 24, 2001 Montana Power Company (MPC) filed an “Application for Approval of a Power Purchase Agreement to Serve Default Supply Customers” (Application). In its Application MPC sought approval of a power purchase agreement (PPA) “by and between Rocky Mountain Power, Inc. (RMP) and [MPC], dated July 23, 2001 (Agreement) for full recovery in its electric default supply rates.” Application, p. 2. Specifically, MPC requested that:

1. the Commission issue a final order approving the Agreement, without change, and finding and concluding as a matter of law that the costs incurred by Applicant under the Agreement are and will be prudently incurred Electricity Supply Costs within the meaning of § 69-8-103(12), MCA, as amended by HB 474, and including a finding that § 69-8-211(8), MCA does not apply and has no effect on the Commission’s determination of prudence or the recovery of these costs in MPC’s default supply rates;
2. the Commission order that the costs incurred by Applicant under the Agreement will be allowed to be recovered in rates through the Electricity Supply Cost recovery mechanism to be adopted under § 69-8-210, MCA, as amended by HB 474;
3. the Commission affirm that its Order in parts 1. and 2. above will be upheld by the MPSC even if HB 474 is repealed or otherwise made ineffective.

Id., pp. 2-3.

2. MPC explained that “Rocky Mountain Power, Inc. will be a newly developed project in Hardin, Montana, planned for a production capacity of 100 MWs. The Agreement between MPC and Rocky Mountain Power, Inc. is for 100 MWh of energy on a unit contingent basis to be delivered to MPC’s transmission system for ten years, beginning on July 1, 2002.” Id. at 3. The contract price and terms of the Agreement are confidential and covered by Commission protective order. The Agreement was filed as part of the Application. MPC asked for Commission approval of the Application by August 15, 2001.

3. In response to the Application the Commission issued, on July 27, 2001, a Notice of Application, Notice of Opportunity to Comment, Notice of Opportunity for Public Hearing (Notice). Regarding comments the Commission specified in the Notice:

The PSC requests interested persons file written comments on the scope of PSC authority and responsibility under § 69-8-210, MCA, in particular whether § 69-8-210, MCA envisions or requires that the PSC can or must approve specific power purchase agreements between MPC and power suppliers: What legal, economic and practical issues arise with MPC’s application in terms of the PSC’s obligation to set default service rates and establish a cost recovery mechanism that recovers prudently incurred costs?

Notice, p. 2. Comments and requests for hearing were due by August 3, 2001.

4. Formal written comments in response to the Notice were received from MPC, the Montana Consumer Counsel (MCC), and the Natural Resources Defense Council (NRDC). The Commission received numerous letters, emails and petitions in response to the Notice, the great majority in favor of MPC’s Application.

#### Summary of the Formal Comments

5. In its comments MPC states the Commission is not required to approve or act on the Application, but should do so as a matter of “sound discretion.” MPC argues that the opposition to “pre-approval” in the traditional regulatory context should not apply in this case.

Because it is trying to build an entire resource portfolio from scratch, MPC needs the Commission’s concurrence on the RMP project to insure that it and subsequent resource additions will conform to the Commission’s vision of a prudently incurred default supply expense, given the highly

volatile market in the West. Since the Commission regulates cost recovery, its vision of prudence is of critical importance to MPC.

MPC comments, p. 4.

6. MPC contends Commission approval of the Agreement would not violate Montana law. It also asserts “that it is not realistically possible to present an entire default supply portfolio at one time for the Commission’s consideration” prior to July 1, 2002. The development of a default supply portfolio requires the Commission to declare on the prudence of each piece of the portfolio as it is presented by MPC. Id. at 5-6.

7. MCC notes that the Application does seek preapproval of a specific resource and “the Commission has consistently declined to engage in preapproval.” MCC comments, p. 1. MCC disagrees that the Commission should approve individual pieces of the default supply portfolio. “Prudence cannot be determined from the sketchy and noncontemporaneous information provided here, or without reference to the overall default supply plan.” Id. at 2. MCC contends that Montana law “does not envision or require that the Commission preapprove power purchase arrangements.” Id. MCC suggests the best reading of Montana law is that the Commission lacks authority to approve MPC’s Application.

8. NRDC contends the Commission has “expansive authority” to oversee electric restructuring and “broad authority” to adopt rules and regulate default supply until competition exists for small customers. NRDC describes various parts of § 69-8-210, MCA, and argues that this section, along with relevant sections of § 69-8-403, MCA, indicate that the Commission should not “review MPC’s proposed default-supply contracts on a piecemeal basis.” NRDC comments, p.2. NRDC asks the Commission to consider three “issues”: 1) The Commission should establish a docket where “MPC’s default supply obligations and proposals would be examined comprehensively”; 2) The Commission does not have enough information to properly evaluate the MPC/Rocky Mountain Agreement; 3) Wind resources, demand side resources and a separate “green-power product” should all be examined as part of a “default-supply portfolio docket.”

Legal Background

9. MPC is a public utility, a distribution services provider and a default supplier. § 69-8-103(8)(10) and (24), as amended at HB 474, Ch. 577, 2001 Session. As the default supplier MPC is required by Montana law to provide for the electricity supply requirements of its default customers. Also by law, MPC is entitled to recover its prudently incurred electricity supply costs, subject to §§ 69-8-211(6)(7) and (8), MCA. The relevant statutory sections are as follows:

(3)(a) The default supplier shall provide for the full electricity supply requirements of all default supply customers. To meet these requirements, the default supplier shall procure a portfolio of electricity supply using industry-accepted procurement practices, which may include negotiated contracts or competitive bidding. The commission may develop reasonable requirements for the use of competitive bidding in the procurement process.

(b) A default supplier may submit material related to proposed bids or contracts concerning electricity supply to the commission before the default supplier enters into the contract. The commission may comment on the material.

(c) In reviewing electricity supply contracts, the commission shall consider only those facts that were known or should reasonably have been known by the default supplier at the time the contract was entered into and that would have materially affected the cost or reliability of the electricity supply to be procured.

(4)(a) The commission shall use an electricity cost recovery mechanism that ensures that all prudently incurred electricity supply costs are fully recoverable in rates. The cost recovery mechanism must provide for prospective rate adjustments for cost differences resulting from cost changes, load changes, and the time value of money on the differences.

(b) The default supplier shall submit a proposed electricity supply cost recovery mechanism to the commission for approval on or before July 1, 2001. A mechanism must be adopted by the commission before March 30, 2002.

(c) The commission shall establish a method to provide for the full recovery of electricity supply costs that extend beyond the end of the transition period.

§ 69-8-210(3)(a)(b)(c)(4)(a)(b)(c), MCA, as amended at Ch. 577 (HB 474), 2001 Session.

10. Montana law does not require the Commission to act on or approve the MPC Application. There is some question whether Montana law permits Commission

approval of MPC's Application; the Commission does not reach a conclusion on that question because, as explained below, the Commission will not approve MPC's Application.

Commission Decision

11. As noted, MPC asked the Commission to approve the Agreement, without change, and to determine that costs incurred under the Agreement are prudent electricity supply costs. MPC stated that if a favorable Commission order is not issued by August 15, 2001, the Agreement allows RMP or MPC to terminate the Agreement. MPC stated that the costs for electricity under the Agreement are economic when compared to the marketplace at this time.

12. The Commission cannot determine that the costs MPC would incur under the Agreement with RMP are prudent without evaluating those costs in conjunction with all other costs MPC will incur to comprehensively satisfy its default supply obligation. MPC's Agreement with RMP alone does not fulfill all MPC's responsibilities under § 69-8-210, MCA. Other electricity supply resources must supplement and complement the quantity, quality, price and terms of the Agreement with RMP so that the resulting portfolio yields reliable default electricity supply at a reasonable price that complies with Commission Order 5986t, Docket D97.7.90. Approving MPC's Agreement with RMP, and its underlying costs, without fully considering how those costs may combine with the costs of other default supply resources could compromise the Commission's ability to review the prudence of a comprehensive portfolio and would be inconsistent with the Commission's role in ensuring recovery of prudently incurred costs.

13. Even if the Commission could reasonably and legally preapprove the Agreement, MPC's application did not contain sufficient information for the Commission to evaluate the terms of the Agreement. MPC provided no evidence to support its claim that the costs in the Agreement are prudent. Although MPC stated that the Agreement was the result of a competitive solicitation, MPC's application did not document the alternative resource options, the scope of due diligence MPC performed on the various alternatives or the decision process that led to an ultimate Agreement with RMP. Further, MPC did not identify the resource acquisition criteria used to evaluate alternative bids or the principles it intends to apply in

building a comprehensive default supply portfolio. The Commission cannot evaluate the prudence of MPC's decisions without such information. MPC's application also unreasonably and inappropriately requested that the Commission grant its approval of the Agreement within approximately 20 days.

14. Although it denies MPC's Application, the Commission does not pass judgment on the Agreement itself. Based on MPC's description of the RMP project, there are aspects of the project that could make an agreement with RMP appealing. The project could lead to additional generation capacity in Montana, which could increase competition among generators, consistent with state policy. As a new source of generation that is not fueled by natural gas it could contribute to resource diversity. The gasification technology that would be incorporated into the project may be cleaner and potentially more efficient than existing coal-fired generation plants in Montana. The contract price, while higher than the unbundled tariffed supply rates, could be blended with other resources to achieve an overall default supply price consistent with the Commission's determination in Order 5986t. MPC has more complete knowledge and understanding of how the RMP project may fit into a comprehensive default supply portfolio and it is MPC's statutory obligation to develop the default supply portfolio. MPC should be cautious about foregoing opportunities to enter power purchase agreements based solely on the Commission's refusal to preapprove cost recovery. MPC's responsibility to develop a default supply portfolio does not depend on preapproved cost recovery. A prudence review involves evaluating the resources MPC acquired as well as resources that could have been acquired and information available to MPC when decisions were made.

15. Finally, to the extent it would benefit MPC in developing the default supply portfolio, the Commission is willing to comment on decision criteria and acquisition principles that MPC intends to use. Such comments would be consistent with § 69-8-210 (3), MCA. As explained in this Order, the Commission's comments would not constitute preapproval, but could reduce MPC's uncertainty about whether it is pursuing a reasonable portfolio development process, which should result in prudent power purchase decisions. This could occur in the context of Docket D2000.10.177 wherein the Commission initiated a dialogue on how MPC would provide default supply service during the extended transition period.

Conclusions of Law

1. MPC is a public utility subject to regulation by the Montana Public Service Commission. § 69-3-101, et seq., MCA.
2. MPC is the default supplier of electricity to default supply customers and must procure a default supply portfolio to meet the full electricity supply requirements of those customers. § 69-8-210, MCA.
3. MPC may, but is not required, to submit material to the Commission related to the development of the default supply portfolio. The Commission may, but is not required, to comment on such material. § 69-8-210(3)(b), MCA.

Order

The Commission declines to take the action requested by MPC in its Application, and therefore denies the Application in this docket. By denying the Application the Commission neither makes a judgment on or reaches a conclusion about the Rocky Mountain Power project or whether it may reasonably be part of a prudent default supply portfolio procured by MPC.

DONE AND DATED this 7th day of August, 2001, by a vote of 4-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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GARY FELAND, Chairman

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JAY STOVALL, Vice Chairman,  
Voting to dissent

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BOB ANDERSON, Commissioner

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MATT BRAINARD, Commissioner

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BOB ROWE, Commissioner

ATTEST:

Rhonda J. Simmons  
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision.  
A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.